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C O N F I D E N T I A L SECTION 01 OF 02 ANKARA 000301

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SUBJECT: EMBASSY PRESSES AK ON ECONOMIC POLICY

REF: SECSTATE 7987

Classified by DCM Robert Deutsch. Reasons: 1.5 (b,d).

11. (C) Summary: Ambassador delivered reftel points to Prime Minister Gul January 9, emphasizing that any possible U.S. financial assistance was conditional on continued implementation of the economic reform program. Embassy delivered the same message January 9 and 13 to Treasury U/S Oztrak and two influential AK parliamentarians. PM Gul assured the Ambassador that he understood the need for reform, and that the government was not "populist." Treasury U/S Oztrak told us he had raised the need for "actions, not promises" in his January 7 meeting with PM Gul, who "completely understands." Oztrak admitted, however, that others in AK, including Party leader Erdogan, still needed convincing. Reflecting that, parliamentarians Reha Denemec and Nazim Ekren agreed on the need to commit to a 6.5 percent primary surplus now, but also said they hope to find opportunities to reduce the surplus in the near future, albeit "in consultation with the IMF." They pointed to Deputy PM Sener's January 11 statement of support for bank reform as a positive step, but at the same time defended amendments to the Public Procurement Law aimed at gutting the authority of the procurement regulatory body. We, the IMF, and the markets will need to maintain steady pressure on AK to implement sound policies. End Summary.

12. (C) Ambassador delivered reftel points to Prime Minister Gul on January 10, noting that the U.S. -- as a friend of Turkey -- was concerned about economic policy slippage. Ambassador reiterated that any potential U.S. financial assistance would also require Turkish implementation of the economic reform program. The Prime Minister said his government was committed to reform, would not succumb to populism, and wanted to put Turkey's "house in order."

13. (C) On January 10, we presented reftel points to Treasury Undersecretary Faik Oztrak, who said he agreed fully with them. "This is the message I gave to PM Gul. The PM called a meeting with economic ministers and agency heads on January 7 after the disappointing Treasury auctions. It was my first meeting with him; I said the time for promises is over, we need to show actions. On the budget, we need to decide now what to cut, and which taxes to raise in order to pay for the increased social spending already announced and to reach the 6.5 primary surplus target. "

13. (C) Oztrak continued that PM Gul understood right away, and pushed for the fiscal savings measures announced January 8 (ref b). "The PM's decision marks a decisive move towards implementing the program. He is concerned about the economy as I am." However, Oztrak noted that this message still needed to go to others in the Party, including Chairman Erdogan and AKP parliamentarians.

14. (C) Oztrak's other key points:

-- Following Oztrak's January 7 meeting with the PM, Gul had telephoned the Danistay (administrative court) to urge acceleration of deliberations on the pending Pamukbank case;

-- On the IMF Fourth Review, "we have a ways to go both on finalizing the Letter of Intent for the 2003 program, and on completing the outstanding conditions. It will not be an easy IMF review, but we have to finish the Review in February." Oztrak said he had told the GOT he need the Fourth Review tranche (\$1.7 billion) in February.

--The Treasury had drawn down its cash balance to meet the

January 8 debt redemptions to its domestic market. Treasury had then raised the cash balance through the \$750 million dollar-denominated external bond offering. "if we proceed to meet the outstanding Fourth Review conditions, and deliver a credible LOI to the IMF, then we should have no problem in our next big T-bill auctions on January 22. Then our cash balance should be restored to the TL 2.5 quadrillion level (about \$1.8 billion)."

15. (C) We also delivered the same message to AK Parliamentarians Nazim Ekren and Reha Denemec, both of whom are close to AK Party Chairman Erdogan, in January 9 and January 13 meetings. (Both are accompanying Erdogan on his trip to China this week.) On fiscal policy, Ekren said AK wanted to fulfill its pre-election promises to the electorate, but now the Party understands that some of its promises will have to be delayed. Denemec said that State Minister Babacan had over the weekend fully confirmed the GOT's adherence to the 6.5 percent of GNP primary surplus. He added, however, that this figure was not "the word of God," and that it might be reduced in the near future, in consultation with the IMF. We stressed that announcing the 6.5 percent target, while progress, was insufficient; the GOT also needed to announce further credible measures to achieve it. Denemec said much of the savings would be achieved by reducing the outstanding public investment projects from 4,400 to 2,000.

16. (C) On banking reform, Ekren said former bank owners were lobbying Chairman Erdogan. "Halis Toprak calls the Chairman every week, trying to get permission to start a new bank. We listen only because he is important to the real sector" (note: Toprak formerly owned Toprak Bank and still owns several factories, including a paper factor in SE Turkey.) But Ekren also said he understood the importance of cleaning up the banking sector and not giving new banking licenses to persons who not only bankrupted their institutions at public expense, but also owed the banking board substantial sums of money. Denemec called attention to Deputy PM Sener's January 11 statement calling on the Cukurova Group (former owner of Pamukbank and majority owner of Yapi Kredi Bank) to pay its debt to the banks in full. Sener said the banking board's actions were fair and legal.

17. (C) Denemec defended AK's plan to amend the public procurement law, saying the law as originally passed was unworkable. He agreed that there is a damaging public perception that the changes are intended to benefit AK-relate firms, but he blamed this perception on media misinformation. He also added that "laws themselves cannot change peoples' behavior" (implying that the construction firms lobbying for GOT contracts would not be deterred by legal changes.) Comment: The IMF and World Bank say the proposed amendments would reduce the law's scope from nearly 100 percent of GOT procurement to about one-third, and would limit the Public Procurement Agency's independence

18. (C) Separately, the Central Bank issued a statement (not yet available in English) stressing the necessity of implementing all aspects of the GOT's economic reform program. The statement notes that reduction of political uncertainty in 2003 (compared with 2002) as a positive factor. It also notes negative factors: an Iraq operation which could depreciate the lira and drive up oil prices; and increases in domestic demand, stimulated by fiscal spending. The statement concludes that, despite the negative factors, "it is not impossible to attain the targeted 2003 inflation rate, if the GOT establishes fiscal discipline and implements structural reforms in line with the program." Note: IMF resrep (protect) told us January 10 that State Minister Babacan had called Central Bank Governor Serdengeçti to complain about this statement, per Serdengeçti. End Note.

19. (C) Comment: Although market developments have served as a useful wake-up call, AK as a whole remains less-than-fully-committed to sound economic policy. In the weeks and months ahead, we, the IMF, and the markets will need to maintain constant pressure.
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